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AT&T

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April 3, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, S.W., Room TWB-204
Washington, D.C. 20554

ORIGINAL

Re: Notice of Ex Parte Presentation:
Access Charge Reform, CC Docket No. 96-262; Request for Emergency Relief of the Minnesota CLEC Consortium and the Rural Independent Competitive alliance, DA-1067; Mandatory Detariffing of CLEC Interstate Access Services, DA 00-1268

Dear Ms. Salas:

Yesterday, Leon Kestenbaum and Richard Juhnke representing Sprint and I representing AT&T met with Kyle Dixon, Legal Advisor to Chairman Michael Powell, to discuss the issue of high priced CLEC access rates. Sprint and AT&T urged the Commission to take immediate action consistent with the AT&T/NewSouth proposal to benchmark CLEC access rates at a level no greater than $0.012 center per minute, converging to the ILEC rate level within a twelve month period. Sprint and AT&T also noted that the Commission should immediately set a benchmark for 8YY traffic at a level no higher than the ILEC rate due to the current practices of some CLECs to aggregate this traffic and share revenues with its end user customer. IXCs are especially concerned that this revenue sharing practice would increase under any proposal that benchmarked CLEC access rates in excess of current ILEC levels. It was also noted that Royce Holland, CEO of Allegiance (one of the CLECs opposed to the proposal), was quoted in a Thursday, November 2, 2000 Communications Daily report as stating that "Allegiance has based access revenue for 2001 on rates of revenue closer to what ILEC's receive...On access charges, 2001 plan factored in rates of 1.5 cents per minute or less for interstate traffic..." Indicating to both AT&T and Sprint, that the starting point of the AT&T proposal was well within the range of reasonableness. In addition, the attached document was also referenced.

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Recycled Paper

Our discussions were consistent with the filed comments of both Sprint and AT&T in the above referenced proceeding

I have submitted two copies of this Notice for each referenced proceeding in accordance with Section 1.1206 of the Commission's rules.

Sincerely,

Attachment

cc: Kyle Dixon
Jeff Dygert
Leon Kestenbaum
Richard Juhnke

Merrill Lynch

Comment

United States
Telecom Services-CLECs

14 February 2001

Ken Hoexter

Shannon Cross

Stefanie Leifer

Brian Tanner

Allegiance Telecom

Overall 4Q00 In-Line As Data Revenues Make Up For Expected Voice Growth

BUY

Long Term BUY

Price: **$24.75**

12 Month Price Objective: $55.00

Estimates (Dec)	2000A	2001E	2002E
EPS:	D$2.56	D$3.15	D$2.60
P/E:	NM	NM	NM
EPS Change (YoY):	NM	NM	NM
Q1 EPS (Mar):	D$0.59	D$0.80	
Cash Flow/Share:	NA	NA	NA
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-1-1-9
Mkt. Value / Shares Outstanding (mn):	$2,722.5 / 110
Book Value/Share (June-2000):	NA
Price/Book Ratio:	NM
ROE 2000E Average:	NA
LT Liability % of Capital:	NA
Est. 5 Year EPS Growth:	NA

Stock Data

52-Week Range:	$110.08-$12.81
Symbol / Exchange:	ALGX / OTC
Options:	None
Institutional Ownership-Vickers:	72.9%
Brokers Covering (First Call):	21

ML Industry Weightings & Ratings**

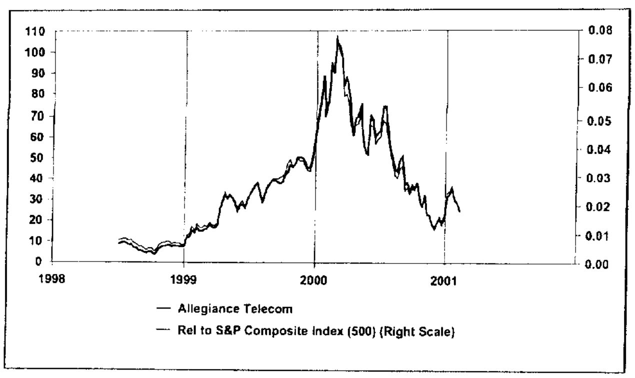
Strategy; Weighting Rel. to Mkt.:		
Income:	Overweight	(25-Oct-2000)
Growth:	In Line	(25-Oct-2000)
Income & Growth:	Overweight	(25-Oct-2000)
Market Analysis; Technical Rating:	Below Average	(12-Feb-2001)

**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

Highlights:

- **Allegiance posted solid overall 4Q00 results with revenues of $95 million (in-line with our estimate and up 19% sequentially), EBITDA losses of $29.9 million (a $2 million sequential narrowing but $0.7 million wider than our estimate), and 108,000 net line adds (8,000 above our estimate and up 18% sequentially).**
- **As is typical of the emerging broadband players this earnings season, the surprise was the breakdown of the revenues. Data revenues were $25 million, up 47% sequentially ($4 million above our estimate, and above our original 22% growth target) while switched local revenues were $66 million, up 10% sequentially ($5 million below our estimate, and below our 19% growth target).**
- **Nevertheless, we maintain our $550 million 2001 revenue estimate, as data revenues should offset declining access rates. We have increased our data contribution during 2001 to 27% of revenues from 21%.**
- **The company posted 108,000 net line adds, its 9th consecutive quarter of increasing line-adds by more than 10,000.**
- **We reiterate our intermediate- and long-term Buy opinion and $55 price objective on Allegiance shares.**

Stock Performance



Merrill Lynch & Co.
Global Securities Research & Economics Group
Global Fundamental Equity Research Department

RC#20104508

Investment Summary

We reiterate our intermediate- and long-term Buy opinion and $55 price objective on ALGX shares. The company's shares currently trade at 3.4x gross PP&E, 4.9x times our 2001 revenue estimate and 5.2x times our 2004 EBITDA estimate, below the 5.0x, 7.3x and 8.7x respective averages of the top tier carriers in the sector. Allegiance targets small- to medium-sized businesses through a targeted smart-build/deferred capital approach, offering local, long distance, data, and Internet services over a mixture of leased local loops for small business customers, HDSL and T1's for medium sized customers, and its own SONET fiber backbone rings. The company currently has 3 fiber rings operational (New York, Dallas, and Houston) and plans to lease dark fiber in 19 of its markets from MFN, Level 3, and others. The company is currently operational in 27 of its 36 target markets, with the remaining 9 to be added in 2001. Its revenue growth is led by its 1,333 "feet-on-the-street" sales force at the end of 2000 (with plans to have 2,000 by year-end 2001). The company posted gross margin topping 50% after three years in operation, and was the first company to electronically bond with an RBOC (Verizon), allowing it to quickly ramp up lines in service.

Fourth Quarter Results

Allegiance reported fourth quarter revenues of $95 million, up 19% sequentially, basically in line with our estimates and an expected slowdown from third quarter's 27% growth. Data revenues were $25 million, up 47% sequentially, and above our $21 million estimate as the company posted actual data revenues that it had booked on an estimated basis in the first 3 quarters of 2000. Switched local revenues were $66 million, up 10% sequentially, but 7% below our expectations; we attribute the shortfall to declining access rates, which represented 22% of fourth quarter revenues, down from 25% in the third quarter. We continue to believe that access revenues will compose 15%-20% of revenues by 4Q01. According to our estimates, average revenue per line/month declined 10% sequentially, larger than our 2% estimated decline, due to a faster-than-expected reduction in the per-minute access rates. Over the next few quarters, the company will have access rates in-line with the incumbent telcos at $0.025 per minute (the other inter-carrier compensation issue, recip comp, remains a non-issue at 3% of revenues and is booked only when the cash is collected). Although we now set an aggressive reduction in average revenue per line per month at 6% q-q in the first quarter, we return to a more normalized 1-3% reduction after that, as access rates begin to settle in at RBOC levels. We maintain our 2001 revenue estimate of $550 million, although we have adjusted the revenue generated by switched local and data to reflect the trends seen in 4Q00.

Revenue Breakdown

($ million)	4Q00a	4Q00e	% Diff	2001 new	2001 old	% Δ
Switched Local	65.7	70.9	-7%	375.6	413.0	-9%
Long Distance	4.2	4.2	0%	24.5	24.0	2%
Data	25.1	20.8	21%	150.0	113.5	32%
Total	95.0	95.9	-1%	550.0	550.5	0%

Source: Merrill Lynch estimates.

The company added 108,000 net lines during 4Q00, up 18% sequentially, and surpassing our estimates by 8%. We are increasing our estimate for full-year net-line adds by 4% to 520,000 from 500,000 as we expect the company to continue to ramp its line growth.

Allegiance reported fourth quarter EBITDA losses of $30 million, a $2 million sequential improvement, but $0.7 million wider than our estimates. We attribute the shortfall to bad debt reserves that the company conservatively booked in 4Q00. Gross margin reached 50% in the fourth quarter, 190 basis points better than our estimates and up 270 basis points from 3Q, as the company realized savings from its own estimated cost of services recorded in the first three quarters of 2000. We estimate that normalized gross margin for the quarter would have been 49% (in line with our estimates) and anticipate that gross margin will return to this level in 1Q01. Subsequently, we believe the company will post sequential benefits to gross margin throughout the year, reaching 53% by 4Q01, and achieve EBITDA break-even in mid-2002. We also maintain our 2001 EBITDA loss estimate of $104 million.

First Nine Markets Reach EBITDA Positive: Demonstrating the success of Allegiance's smart build (delayed capital) business model, the company has begun reporting the results of its first nine markets in operation, which have all achieved positive EBITDA (pre corporate overhead) after only 1.5-2 years of operation. The nine-markets (33% of total markets) had 4Q00 revenues of $59 million (62% of total revenues), up 7% sequentially, a slowdown from 10% the prior quarter. Gross margin was 57% for the first 9 markets (above company average of 50%), and posted a combined EBITDA of $11.6 million, up 27% sequentially. To date the company has installed 376,000 lines in these nine markets (66% of total company lines), with net-adds of 59,500, up 42% sequentially, and representing a 4.7% penetration in these markets to date.

Fully Funded: Allegiance ended the year with nearly $1.2 billion in cash available ($670 million cash and a $500 million untouched credit facility). We continue to believe that the company remains fully funded to free cash flow breakeven (estimated in 2004). Separately, the company has begun to clean up its balance sheet as DSOs fell to 90 days from 93 in the third quarter as it reshapes its back office. Allegiance is rolling out a new billing infrastructure throughout 2001, which should increase the number of billing cycles from its current once a month cycle, allowing it to further improve its DSOs.

(Continued)

Allegiance Selected Performance Data

	1Q00a	2Q00a	3Q00a	(est.) 4Q00e	(act.) 4Q00a
Revenues ($ mil.)	$47	$63	$80	$96	$95
Sequential Revenue Growth	20%	33%	27%	20%	19%
Gross Margin	43%	45%	48%	49%	50%
EBITDA ($ mil.)	($28)	($28)	($32)	($29)	($30)
EPS	($0.59)	($0.52)	($0.67)	($0.71)	($0.77)
Access Lines ('000)	314	408	500	600	608
Net Line Adds ('000)*	73	81	92	100	108
Capital Expend. ($ mil.)	$103	$100	$141	$87	$101
Gross PP&E ($ mil.)	$540	$647	$795	$882	$907

Source: Merrill Lynch estimates and company reports.

Recent Developments

Acquisitions

During the quarter, Allegiance acquired CTSnet, a San Diego based ISP, and Jump.net, a Austin based ISP. We estimate that the company paid approximately $20 million in total cash for the 2 acquisitions. We believe these acquisitions are in-line with the $20 million acquisitions the company has made in each of the two previous quarters and that the ISPs should blend in well with Allegiance's centralized data subsidiary.

Allegiance Telecom Quarterly Earnings Model, 2000a-2001e ($ millions)

	1Q00a	2Q00a	3Q00a	4Q00a	2000a	1Q01e	2Q01e	3Q01e	4Q01e	2001e
REVENUES										
Switched Local	34.2	48.0	59.6	65.7	207.5	74.0	86.9	100.1	114.5	375.6
Long Distance	2.0	2.0	3.4	4.2	11.5	4.9	5.7	6.5	7.3	24.5
Data/Internet	11.0	13.1	17.0	25.1	66.2	26.1	31.4	40.8	51.6	150.0
Total Revenues	47.2	63.0	80.0	95.0	285.3	105.0	124.1	147.4	173.5	550.0
Expenses										
Cost Of Services	27.1	34.6	41.9	47.2	150.7	53.8	62.0	72.6	81.6	270.0
Gross Margin	*20.1*	*28.5*	*38.2*	*47.8*	*134.5*	*51.2*	*62.0*	*74.8*	*92.0*	*280.0*
Selling, General, & Administrative	48.0	56.7	69.9	77.8	252.4	80.3	89.9	99.8	114.0	384.0
Total Cash Expenses	75.1	91.3	111.7	125.0	403.1	134.1	152.0	172.4	195.6	654.0
EBITDA (normalized)	(27.9)	(28.3)	(31.7)	(29.9)	(117.8)	(29.0)	(27.9)	(25.0)	(22.0)	(104.0)
Depreciation & Amortization	21.4	25.4	40.5	49.5	136.8	44.9	45.9	46.9	47.9	185.7
Operating Income (Loss)	(49.3)	(53.7)	(72.2)	(79.5)	(254.6)	(74.0)	(73.8)	(71.9)	(70.0)	(289.7)
Other income (expense)										
Interest Expense	(21.0)	(15.3)	(16.3)	(16.6)	(69.2)	(17.6)	(17.9)	(18.2)	(18.5)	(72.2)
Interest and other income	13.5	16.4	15.1	11.9	56.9	6.3	5.5	4.7	4.1	20.5
Dfd Mgmt Ownership Alloc. Charge	(4.4)	(4.1)	-	-	(8.6)	(2.0)	(1.5)	(1.0)	-	(4.5)
Pretax Income	(61.2)	(56.7)	(73.3)	(84.1)	(275.4)	(87.4)	(87.8)	(86.4)	(84.4)	(346.0)
Income Tax expense (benefit)	-	-	-	-	-	-	-	-	-	-
Net Income (Loss) before Pfd Div.	(61.2)	(56.7)	(73.3)	(84.1)	(275.4)	(87.4)	(87.8)	(86.4)	(84.4)	(346.0)
Accretion of Pfd Stk & Wrnt Values	-	-	-	-	-	-	-	-	-	-
Net Income	(61.2)	(56.7)	(73.3)	(84.1)	(275.4)	(87.4)	(87.8)	(86.4)	(84.4)	(346.0)
	Includes 7.1 million shares issued in Feb.									
Earnings Per Share (EPS)	(0.59)	(0.52)	(0.67)	(0.77)	(2.56)	(0.80)	(0.80)	(0.79)	(0.77)	(3.15)
Wtd. Average Shares Outstanding	104.1	108.4	108.9	109.6	107.8	109.7	109.7	109.8	109.8	109.8
Fully Diluted EPS	(0.57)	(0.49)	(0.63)	(0.72)	(2.42)	(0.75)	(0.75)	(0.74)	(0.72)	(2.97)
Fully Diluted Shares Outstanding	106.9	115.2	115.8	116.5	113.6	116.5	116.6	116.6	116.7	116.6
NETWORK STATISTICS	Excludes 12,400 from Interaccess and Connectnet									
CLEC Lines In Service (000's)	314.3	407.8	499.7	607.7	607.7	722.7	847.7	982.7	1,127.7	1,127.7
Net Adds - Lines In Service (000's)	72.6	81.1	91.9	108.0	366.0	115.0	125.0	135.0	145.0	520.0
C/O Collocations	395	475	552	636	636	700	760	805	850	850
C/O Collocation Net-Adds	68	80	77	84	309	64	60	45	45	214
Markets	20	24	25	27	27	30	33	36	36	36
Capital Expenditures ($ mil.)	103	100	141	101	444	130	105	75	40	350

Allegiance Quarterly Revenue Growth and Margin Analysis, 2000a-2001e

	1Q00a	2Q00a	3Q00a	4Q00a	2000a	1Q01e	2Q01e	3Q01e	4Q01e	2001e
Revenue Growth (sequential)										
Switched Local	10%	40%	24%	10%	157%	13%	17%	15%	14%	81%
Long Distance	-47%	-1%	71%	25%	27%	17%	16%	14%	13%	112%
Data/Internet	144%	19%	31%	47%	630%	4%	21%	30%	27%	127%
Total Revenues	20%	33%	27%	19%	188%	11%	18%	19%	18%	93%
Expense Growth (sequential)										
Cost Of Services	13%	27%	21%	13%	141%	14%	15%	17%	12%	79%
Selling, General, & Administrative	14%	18%	23%	11%	79%	3%	12%	11%	14%	52%
Total Cash Expenses	14%	22%	22%	12%	98%	7%	13%	13%	13%	62%
Depreciation & Amortization	3%	19%	59%	22%	145%	-9%	2%	2%	2%	36%
EBITDA Growth	n/m	n/m	n/m	n/m	n/m	n/m	n/m	n/m	n/m	n/m
Expenses as % of Revenues										
Cost Of Services	57%	55%	52%	50%	53%	51%	50%	49%	47%	49%
Gross Margin	*43%*	*45%*	*48%*	*50%*	*47%*	*49%*	*50%*	*51%*	*53%*	*51%*
Selling, General, & Administrative	102%	90%	87%	82%	88%	76%	73%	68%	66%	70%
Total Cash Expenses	159%	145%	140%	132%	141%	128%	123%	117%	113%	119%
Depreciation & Amortization	45%	40%	51%	52%	48%	43%	37%	32%	28%	34%
EBITDA Margin	-59%	-45%	-40%	-32%	-41%	-28%	-23%	-17%	-13%	-19%
Operating Margin	-104%	-85%	-90%	-84%	-89%	-70%	-60%	-49%	-40%	-53%
Pretax Margin	-130%	-90%	-92%	-89%	-97%	-83%	-71%	-59%	-49%	-63%
Effective Tax Rate	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Net Margin	-130%	-90%	-92%	-89%	-97%	-83%	-71%	-59%	-49%	-63%

Source: Merrill Lynch estimates.